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SUBJECT: The Japan Economic Scope--July 19, 2007 Part 1

Sensitive but unclassified. Please protect accordingly.

¶1. (U) This cable contains the part one of the Japan Economic Scope from July 19, 2007.

2.(SBU) Table of Contents

- ¶13. Reaction to Doha Draft Texts**
- ¶14. Japan Agriculture: Doha Draft Text Triggers Customary Hyperbolic Response**
- ¶15. Battered Agriculture Minister Faces Press**
- ¶16. FSA Creates Special Unit to Supervise Postal Savings and Insurance after JP Privatization**
- ¶17. Japan Hosts Regional FAA Seminar**
- ¶18. Aviation Liberalization in LDP Manifesto**
- ¶19. KIX Welcomes Expansion of Haneda Service**
- ¶110. KIAC, Osaka need 24-hour KIX Customs**
- ¶111. Third Meeting of KIX Study Group**
- ¶112. Haneda adds Shanghai Charter flight slots**
- ¶113. New Directors at Civil Aviation Bureau**
- ¶114. Star Flyer to fly PR Charter to KIX on Aug. 2**
- ¶115. GM on Japan Auto Fuel Cell Efforts**
- ¶116. ACCJ Business White Paper**
- ¶117. Performance-paid Bonuses: Tops and Drops**

¶13. (SBU) Reaction to Doha Draft Texts

The draft texts for the Doha Round agriculture and non-agriculture market access (NAMA) negotiations have been released in Geneva and affected ministries in the Japanese government are crafting a joint statement as the Scope goes to press.

GOJ contacts have emphasized that while Japan has concerns about the texts, they are at least a basis for further discussion as the chairs put in considerable effort to reflect the broad concerns of the WTO membership. On the agriculture text, the GOJ welcomes the fact that the draft does not mention tariff caps. A major concern the GOJ has about the agriculture draft text is the focus on "dutiable lines," rather than "all" lines. GOJ contacts say that that emphasis will penalize countries which already have a high percentage of duty free products entering the country. A quarter of Japan's agricultural imports already enter duty free. If Japan applied a one percent tariff, these products would be included in the calculation for determining the number of sensitive items, giving Japan's greater latitude, GOJ contacts noted.

Meanwhile, the Ministry of Economy, Trade, and Industry (METI),

according to press reports, is not content that the draft text for the NAMA negotiations is lenient toward developing countries. METI argues that the ceiling for tariffs on industrial goods is insufficient to provide "real" access to developing country markets.

Press commentary has been mixed. The Yomiuri and Mainichi newspapers underscored that WTO members will find it difficult to gain agreement on a Doha deal before the end of the year. The newspapers express concern about the lack of leadership in the talks since the G-4 negotiations broke down in June. Adding to the gloom, the Mainichi notes that Trade Promotion Authority in the United States has expired.

Nikkei's reaction is more optimistic, saying that the agriculture draft could offer a way for Japan to maintain its high tariffs on rice because there is no mention of tariff caps. The Yomiuri notes that the United States may have to compromise on domestic supports, lowering its levels below its current offer of \$17 billion. (ECON: Nicholas Hill/Ryoko Nakano)

¶4. (SBU) Japan Agriculture: Doha Draft Text Triggers Customary Hyperbolic Response

The draft text for the Doha Round agriculture negotiations as written would "devastate" the farming sectors in big food importing countries, according to Japan Agriculture (JA) Chair Isami Miyata based on a July 18 report in the Japan Agricultural News.

According to the press report, Miyata, did, however, welcome that WTO agricultural negotiations chair Falconer did not include any

TOKYO 00003321 002 OF 005

JA, which is the lobbying arms of Japan's most protectionist-minded farmers, has been making its opposition to a trade-liberalizing agricultural Doha deal well known. JA has organized a number of public demonstrations in recent weeks to air its views in the lead up to Japan's Upper House Diet elections on July 29. (ECON: Ryoko Nakano/Nicholas Hill)

¶5. (SBU) Battered Agriculture Minister Faces Press

Agriculture Minister Akagi turned up at a press conference on July 17 with big bandages on his face. Reporters kept asking him how he was, what happened, but the embattled minister deflected the questions. He told reporters only that he has sensitive skin that occasionally "flares up."

Agriculture Ministry (MAFF) officials claim ignorance regarding Akagi's ailment. The only thing that is clear is that when Akagi arrived back in Japan over the weekend from Geneva, where he met WTO Director General Pascal Lamy and others to discuss the Doha Round, he appeared healthy and unblemished. (ECON: Nicholas Hill)

¶6. (U) FSA Creates Special Unit to Supervise Postal Savings and Insurance after JP Privatization

On July 13, the Financial Services Agency (FSA) announced the appointment of Yasushi Kanzaki, former Director of the Inspection Bureau's Evaluation Division and former Director of International Affairs at the time of the January 2006 Insurance Talks, to the newly created "Counselor's Office to Supervise Postal Savings and Insurance," a special unit in FSA's Supervisory Bureau to oversee postal savings and insurance after Japan Post (JP) privatization. The special unit was created to cope with the major surge in workload that will follow privatization. A/EMIN Fantozzi met Kanzaki on the day of the new appointment. (ECON: Ai Kaneko)

¶7. (U) Japan Hosts Regional FAA Seminar

Japan Airlines (JAL) and All Nippon Airways (ANA) sponsored an FAA Safety Training seminar on July 10 and 11 for 190 technicians, engineers and government authorities from 12 different Pacific countries and economies.

Mitsuo Kawakami, the Director for Standards and International Affairs Airworthiness Division of the Japan Civil Aviation Bureau (JCAB), gave a presentation on Japan's view of potential problems due to a recent and increasing trend of outsourcing maintenance. From the view of Japan's civil aviation authorities, the biggest problem with this trend is the potential lack of oversight, which they intend to curb by holding airlines and the JCAB inspectors accountable for maintaining vigilance in maintenance. In the United States, the 1996 ValuJet aircraft accident was partially attributed to maintenance failures resulting from improper oversight of outsourced maintenance.

One presentation by the FAA triggered a particularly animated discussion about the relationship between profit-seeking and safety. This inspired much interest among JAL employees whose company is now \$17 billion in debt. (ECON: Charlotte Crouch)

¶8. (U) Aviation Liberalization in LDP Manifesto

The Liberal Democratic Party (LDP) has included aviation liberalization among the 155 policy objectives listed in its manifesto for the July 29 Upper House elections. The manifesto calls for "establishing flow of people and goods to strengthen international competitiveness." Under this banner will be the promotion of aviation liberalization (Asian Open Skies), international charter flights from regional airports, and liberalization of route settings to revitalize regions through tourism enhancement.

It also promotes 24-hour operations, internationalization, and improved access to Narita, Haneda (HND), Kansai International Airport (KIX), and Chubu international airports. The manifesto also states that the party will promote the Prime Minister's

TOKYO 00003321 003 OF 005

"Asia Gateway" vision. (ECON: Junko Nagahama)

¶9. (U) KIX Welcomes Expansion of Haneda Service

The Ministry of Land, Infrastructure and Transportation (MLIT) announced on July 9 it would add 10 daily slots at Tokyo's Haneda Airport in September 2007. Kansai International Airport (KIX) will pick up four slots.

As reported last week, Star Flyer is interested in slots for its HND-KIX service. According to an international affairs manager at Kansai International Airport Co. (KIAC), MLIT is going to allocate the new slots equally among interested carriers, which could include JAL and ANA.

The Osaka edition of the Asahi Shinbun newspaper on July 12 discounted the idea that the major airlines would increase profits by adding additional HND-KIX flights, because JAL and ANA are already stuck at approximately 60 percent load factors, the lowest level for profitability.

Nonetheless, KIAC welcomes the decision and would like to fill its 10:00 a.m. -- 3:00 p.m. gap in Tokyo service from Osaka. (Osaka-Kobe: Phil Cummings/Naomi Shibui)

¶10. (SBU) KIAC, Osaka need 24-hour KIX Customs

According to an Osaka Prefecture Government official, KIAC and Osaka Prefecture applied for 24-hour operations at Kansai International Airport (KIX) Customs as a special zone on July 6. Under the current law, customs operates from 8:30 a.m. to 5:00 p.m., with extra fees and paperwork required for operations after 5:00 p.m.

A KIAC official commented that around the clock customs processing is necessary for KIAC to take full advantage of the new capacity offered by its second runway, particularly for cargo operations. (Osaka-Kobe: Phil Cummings/ Scott Ravenhill/ Naomi Shibui)

¶11. (SBU) Third Meeting of KIX Study Group

The Osaka-Kobe Consulate General joined the third meeting of the Kansai International Airport (KIX) study group for the promotion of KIX-U.S. routes on July 13.

KIAC Vice President Tadakuni Hirano believes it is unlikely that a Japanese airline will restart any KIX--U.S. flights. Consequently, KIAC is asking other Asian airlines such as Thai Airways, Korean Airlines, and Vietnamese Airlines to start flights from their respective countries to the U.S. via KIX. Vietnamese Airlines is considering opening a flight to Los Angeles (LAX) through KIX, Incheon, or Shanghai in 2008. Also, Thai Airways is contemplating resuming its Bangkok-KIX-LAX flight. Current GOJ restrictions on "passenger beyond" rights mean that stopovers would be limited to refueling stops, if KIAC is able to secure special landing permission from MLIT. KIAC continues to monitor aviation talks between GOJ and its market countries. The Japan Association of Travel Agents (JATA) Kansai Director discussed difficulties travel agents have selling U.S. tour packages departing from KIX. He claimed that United Airlines (UA) has an excessively restrictive policy on travel agent bookings for tour groups, which ultimately harms UA's business. Study group members were also interested in promoting the HND--KIX--U.S. route upon the expansion of slots at Haneda starting in September.

Other participants in the meeting included the Kansai Economic Federation, Osaka Prefectural Government, and the Osaka Chamber of Commerce and Industry. (Osaka-Kobe: Phil Cummings/Scott Ravenhill/Naomi Shibui)

¶12. (U) Haneda adds Shanghai Charter flight slots

MLIT will create 10 additional daily aircraft flight slots at Tokyo's Haneda Airport starting in September, according to a July 13 announcement. The objective is to provide time for charter flights between Haneda and Shanghai's Hongqiao Airport, and an

TOKYO 00003321 004 OF 005

expansion of overseas routes from HND via KIX with the enhanced flight connectivity.

MLIT is increasing slots by improving the high speed exit taxiway. Currently, 31 slots are available per hour, and the new slots will be available by adding one more slot per hour over the 10 hours of daily airport operations. This is part of the steady implementation of the Asian Gateway Vision which includes an initiative to increase daytime slots at HND.

The 10 new slots were announced by MLIT to be allocated as follows: four flights for ANA Cargo and ANA International to operate as a Hongqiao/Haneda charter; Star Flyer with four flights for HND to improve connections to KIX; and two flights for regional airports to be given to ANA Corp., Skymark and JAL international.

The two flights given to regional airports routes will be divided evenly among the three companies that applied for them. (ECON: Junko Nagahama)

¶13. (U) New Directors at Civil Aviation Bureau

MLIT has announced changes in senior level personnel. Hiroshi Narahara was chosen as the new director of the International Air Transport Division. Former director, Tadashi Shimura, became the

director of the International Policy Planning Unit on July 10. Yousuke Kanba, current Special Assistant under the section which handled aviation related issues during the May U.S.-Japan regulatory reform talks, will stay in his position.

For the newly established section for air cargo policies, Koji Tamura has been appointed as director, the first from the private sector. Tamura previously worked at the Mitsubishi Trading Co. His deputy director is Hirotoshi Ohtsubo.

Civil Aviation Bureau Director-General Hisayasu Suzuki will remain in his position, and so will Deputy DG Ryuhei Maeda, the principal negotiator with the U.S. on civil aviation matters.
(ECON: Junko Nagahama)

¶14. (U) Star Flyer to fly PR Charter to KIX on Aug. 2

On August 2, the opening day of the second runway at KIX, Kitakyushu-based airline Star Flyer (SFJ) will conduct a charter flight from Kitakyushu to KIX. Showcasing its impressive "black" aircraft, SFJ hopes to increase name recognition in the Kansai region prior to the start of scheduled HND -- KIX flights. Following the July 13 MLIT decision to allocate four HND-KIX slots to SFJ starting in September, the airline announced that it expects to begin four daily round-trip flights on Sept. 14. SFJ, modeled after JetBlue Airways, began operations in March 2006, offering 12 (later dropped to 11) regular daily round-trip flights from Kitakyushu to HND. The average load factor (LF) for the first year, however, was only 57.5 percent, well below the company's breakeven point of 62 percent. SFJ believes the new HND-KIX route will be a key factor in turning its struggling business around.

Additionally in June 2007, SFJ began code-sharing with ANA on the Kitakyushu-HND line, significantly improving its June LF to 67.6 percent, up 19.1 percent from the previous year. (Fukuoka: James Crow/Yuko Nagatomo)

¶15. (SBU) GM on Japan Auto Fuel Cell Efforts

At an Embassy briefing in early July, a General Motors (GM) fuel cell representative said the GOJ has spent over \$1.55 billion since 2000 on fuel cell research and development driven by concerns over CO₂ reduction and energy security as well as industrial policy.

GM monitors developments here not only to help their own fuel cell efforts, but to avoid as the GM rep. put it, "what happened with hybrids," i.e., any Japanese commercial surprises. GM itself has invested over a billion in fuel cell technology in the past five years. In addition to Japan, GM is active in Korea and China. Since the petroleum infrastructure is still underdeveloped in China and centralized planning still has some

TOKYO 00003321 005 OF 005

cache, a potential for setting up a hydrogen infrastructure exists.

GM was granted approval in March 2003 for GM HydroGen3 to drive on public roads in Japan. It is the first liquid fuelled fuel cell vehicle so licensed and it participates in the JHFC program, which supports the single liquid hydrogen refueling station in Japan (Ariake in Tokyo). FedEx has used the vehicle for deliveries in Tokyo with some success. GM is working with Suzuki to put a fuel cell in one of their vehicles.

METI, in coordination with MLIT and the Ministry of Environment (MOE), sets the budget, policies, and strategy on fuel cells. Haruhiko Ando, the Director of the New and Renewable Energy Division and also the Director of Fuel Cell and Hydrogen Strategy Office under METI's Agency of Natural Resources and Energy (ANRE) recently left his position. Ando played a key role in guiding Japan's fuel cell research and development during the past four years, and his departure has left some in industry worried about

the future direction of Japanese fuel cell research and development.

For more on the meeting see the attached memo from Koichi Uchida of the DOE Attach's office. The GM representative also left a 20-page PowerPoint presentation on their work. If you would like a copy, contact Josh Handler. (ECON: Josh Handler).

116. (U) ACCJ Business White Paper

The Business White Paper, entitled "Working Together, Winning Together," of the American Chamber of Commerce in Japan (ACCJ) is now available on the ACCJ website. The white paper identifies structural measures to bolster economic growth and innovation, and calls on the governments of the U.S. and Japan to reach a conclusion on a comprehensive bilateral Economic Integration Agreement. It is also a source for business and economic issues facing Japan, as well as recommendations on specific issues such as the financial system, healthcare, information technology, government reform, and privatization. (ECON: Virsa Hurt).

117. (U) Performance-paid Bonuses: Tops and Drops

For the fifth straight year, summer bonuses rose 2.5 percent in Japan. Based on a Nikkei survey covering 790 companies, the average bonus was 837, 036 yen (\$6900), with Nintendo Co. paying its employees the highest bonuses overall. Within sectors, Toyota led the automotive and auto parts sector and Mitsubishi and Sharp led the electric machinery sector.

Meanwhile, some companies have had to cut bonuses. Steelmakers and paper and pulp industry paid the lowest bonuses this summer due to rising material and fuel costs. Honda, Nissan and Hitachi cut bonuses due to sluggish performance.

The increased use of performance-based payments of bonuses has been blamed as the reason for the widening gap in bonus payments among companies. Until recently bonuses, which make up as much as 20 percent of more of the annual income of individual Japanese workers, were based on seniority and economic growth, and were almost equal across entire industries. Performance-based payments started to gain popularity with firms in the late 1990s as more firms looked to raise incentives for their employees by changing the bonus system.

The same phenomenon can also be seen among workers within the same company. Some 47 percent of the firms that responded to Nikkei's survey said that there is a 50 percent or higher gap between the lowest and highest bonuses for employees who were hired during the same year. (ECON: Virsa Hurt)

SCHIEFFER